

## EFAB Report

### EFAB

**Robin L. Wiessmann**  
*Chair*

**Richard B. Geltman**  
*Vice Chair*

**Herbert Barrack**  
*Executive Director*

# *Environmental Financial Advisory Board*

### Members

*Honorable Pete V. Domenici  
Honorable Beryl F. Anthony, Jr.  
Honorable Stephen Goldsmith  
Honorable Maynard Jackson  
Mitchell W. Berger  
Jodie Bernstein  
Joseph D. Blair  
George H. Butcher, III  
Pete Butkus  
William H. Chew  
Euford L. Cooper  
Michael Curley  
Peter M. Emerson  
Sarah W. Eubanks  
DeeAnn Farris  
Shockley D. Gardner, Jr.  
Patricia Garrison-Corbin  
William B. James  
Susan P. LeGros  
Paul F. Levy  
David M. Lick  
Marlin L. Mosby, Jr.  
Robert J. Mulready  
George V. Pedruza  
Deborah A. Photiadis  
George A. Raftelis  
Heather L. Ruth  
Roberta H. Savage  
Robert P. Schwartz  
Jim J. Tozzi  
Warren W. Tyler  
Susan P. Vogt  
Frieda E. Wallison  
Mary Ellen Whitworth  
Neil Yoskin  
Elizabeth Yell*

---

## CREATING A VIABLE FINANCE PROGRAM FOR THE BORDER ENVIRONMENTAL COOPERATION COMMISSION AND THE NORTH AMERICAN DEVELOPMENT BANK UNDER THE NORTH AMERICAN FREE TRADE AGREEMENT

---

This report has not been reviewed for approval by the U.S. Environmental Protection Agency; and hence, the views and opinions expressed in the report do not necessarily represent those of the Agency or any other agencies in the Federal Government.

*August 1994*

*Printed on Recycled Paper*

AUG 29 1994

Honorable Carol M. Browner  
Administrator  
U.S. Environmental Protection Agency  
Washington, D.C. 20460

Dear Administrator Browner:

On behalf of the Environmental Financial Advisory Board (EFAB), we are very pleased to transmit to you the EFAB Report, Creating a Viable Finance Program for the Border Environmental Cooperation Commission and the North American Development Bank under the North American Free Trade Agreement. In this report, the fourth in a series on financing environmental needs along the U.S./Mexican border, we recommend steps to assist in achieving the overall financial integrity of the NAFTA institutions and in providing the necessary funding for border environmental needs.

The Board recommends the immediate marshalling of human and financial resources in order to create from the onset a sound and solvent financial structure of the NAFTA institutions. We advise the creation of a prototype program located in one or more areas in need of environmental projects. A prototype program would include such components as: legal, regulatory and administrative analyses to create and operate user fee based, special purpose districts; marketing analyses to determine level of service and pricing policies; training programs for the technical, financial, and administrative personnel operating the system; and, a program of public education and information aimed at the actual service users. These projects should be structured as models of financial integrity and be targeted as the first to be funded by the new NAFTA financial institutions. They should also serve as prototypes for future NAFTA projects.

The recommendations in this report and in our previous reports on border financing are particularly timely in assisting the current bilateral efforts, i.e. the Border Environmental Cooperation Commission (BECC) and the North American Development Bank (NADBank), to create and maintain a quality environment along the border. The Board offers its assistance to the Administrator in your capacities as a director of the BECC and of the NADBank. We are available at your convenience to discuss our recommendations and to provide any further analyses you may require.

Sincerely,



Robin L. Wiessmann  
Chair, Environmental  
Financial Advisory Board



Herbert Barrack  
Executive Director, Environmental  
Financial Advisory Board

**Environmental Financial Advisory Board**  
**of the**  
**United States Environmental Protection Agency**

---

**Report on**  
**Creating a Viable Finance Program**  
**for the**  
**Border Environmental Cooperation Commission**  
**and the**  
**North American Development Bank**  
**under the**  
**North American Free Trade Agreement**

---

In 1992, the Environmental Financial Advisory Board (EFAB) resolved to review the problem of financing environmental infrastructure along the Mexican border in support of the Administrator's efforts to assist in the negotiation and passage of the North American Free Trade Agreement (NAFTA). The Board delegated the responsibility for this matter to the International Committee. The Committee has issued four reports on this issue which the Board has adopted. This is the fourth report in that series.

## SUMMARY

In a bilateral side agreement to the North American Free Trade Agreement (NAFTA), the United States and Mexico created a mechanism to finance environmental infrastructure projects along the border. The side agreement provides a funding level of \$450 million of paid-in cash and an additional \$2.55 billion of call capital. This Committee has, in two previous reports, called for the leveraging of these funds to the maximum extent to which it is both feasible and financially sound. Assuming such funds are leveraged at between a 2:1 and 3:1 ratio, the NAFTA capital will produce between \$6 and \$9 billion to finance environmental infrastructure projects needed along the U.S. - Mexican border.

This is an event of truly historic significance. Designated financing is at hand to help remedy a major international environmental problem. The opportunity to realize this vital goal must not be lost.

To seize this truly global opportunity, the full funding potential of the institutions envisioned by the NAFTA must be achieved. To do so requires that work begin immediately to help border communities design cost effective projects and to assure that each project will be financed on a sound and solvent basis. These steps will preserve the overall financial integrity of the NAFTA institutions and provide funds to clean up the entire border area. That is the subject of this report.

The Committee recommends - as its highest priority - the immediate marshaling of the human and financial resources necessary to create from the onset a sound and solvent financial structure for the NAFTA institutions. Specifically, the Committee recommends the immediate creation of a prototype program located in one or more areas in need of environmental infrastructure projects. These pilot projects should be structured as models of financial integrity and they should be targeted as the first to be funded by the new NAFTA financial institutions. They should also serve as the prototypes for all future NAFTA projects.

## BACKGROUND

Under the bilateral side agreement, the responsibility for financing environmental infrastructure is divided between two new binational agencies, the Border Environmental Cooperation Commission (BECC) and the North American Development Bank (NADBank).

The side agreement envisions the BECC as an agency whose purpose is to work with communities to generate needed environmental infrastructure projects. The BECC's role will be to coordinate the planning, design and financing of these projects and then to "certify" them for funding to the NADBank. The BECC will have a ten-member binational board of directors on which the Administrator will serve. The BECC will consult with an 18-member Advisory Council, of which nine members will come from each country. The degree of local participation, as well as public notification and comment on proposed projects, will be unprecedented.

The NADBank will be capitalized over a four year period with \$225,000,000 of cash each from the United States and Mexico and with an additional \$1,275,000,000 of callable capital from each. Ninety percent of the bank's funds will be used to finance environmental infrastructure projects, with the balance made available for community adjustment assistance. The stated purpose of the NADBank is to fund, "as appropriate", projects "certified" by the BECC. The NADBank is to have a six-member board, three from each country. It is expected that the Administrator will serve as one of the U.S. directors of the NADBank. In addition, for the purposes of loans or guaranties certified by the BECC, it is also expected that the U.S. representatives to the NADBank will be instructed in accordance with the procedures of the National Advisory Committee on International Monetary and Financial Policies, as established by Executive Order Number 11269 of February 14, 1966, and that for these purposes the Administrator shall also be a member of the National Advisory Committee. This advisory committee was formed to coordinate U.S. policy for international lending institutions.

The side agreement also provides: "that, to the extent practicable, environmental infrastructure projects in the border region should be operated and maintained through user fees paid by polluters and those who benefit from the projects, and should be subject to local or private control." This commitment is very important to the financial integrity of BECC/NADBank projects and to the effectiveness of these new institutions.

The most important task, then, facing the BECC and the NADBank is to create an operational structure and financial regime which will insure project design and user fee based financing decisions that emanate from, and are controlled by, local communities. Local accountability for project costs and revenues will benefit both environmental and financial performance.

This is an enormous undertaking. It not only involves the creation of a local finance system in Mexico, but the creation of new systems of local government as well.

## RECOMMENDATIONS

To accomplish this huge task, the Committee recommends the following seven initial steps to be undertaken as soon as possible:

1. The BECC must create a team of Mexican and American legal experts charged with the mandate to determine what legal and regulatory steps are necessary to create user fee based, special purpose districts. These geographic areas would serve as either the franchise area for a concession, if the private utility model is to be used, or as the political jurisdiction itself, if the special purpose public district model is to be used. The team must identify the legal and regulatory steps necessary either to grant a concession to such an area or to create the appropriate political subdivision. The environmental side agreement refers to local environmental service areas as "special purpose corporations" (SPCs). Regardless of whether such SPCs are public or private they must be vested with the legal authority:

- A. to conduct the basic enterprise of running an environmental infrastructure system;
- B. to collect user fees and to exercise the appropriate legal sanctions for non-payment; and,
- C. to incur indebtedness, and, if they are to be private companies, issue shares of stock.

SPCs are limited-purpose, financially autonomous entities. They are single function entities. Their financial "autonomy" is restricted to the use of a highly limited set of fees. They do not involve any general powers to tax, nor the exercise of any police powers to sanction non-payers.

2. The BECC must undertake marketing analyses to determine the level of service to be provided to households and businesses, and most importantly, to determine the projected pricing levels for these services. These are absolutely critical measures. Systems must not be developed in isolation from their end users. People currently without any environmental infrastructure services still obtain drinking water today from somewhere. They still dispose of both wastewater and solid waste somehow - no matter how unsatisfactorily. Services must be designed to levels which are both acceptable and desirable to potential users; and, most importantly, the projected pricing of such services must relate directly to the quality of the service and to the improvement in the basic quality of life which they provide. Finally, the pricing must above all be affordable. One of the greatest dangers would be for a new system to provide unnecessary or discretionary services at prices which the average household user could not afford. This would truly be disastrous. Critical resources would be wasted and the entire financial regime contemplated by the NAFTA for the border region could be threatened.

3. The BECC must immediately establish training programs for three specific purposes:

- A. to train technical and engineering personnel to operate the system. A significant number of existing water treatment

facilities in Mexico are not functional; primarily due to the lack of trained personnel.

B. to train financial staff in the areas of collections, payments, budgeting, rate setting, capital planning and debt financing. This is especially critical. These skills exist in the border region, but are in short supply in the field of environmental infrastructure.

C. to train administrative staff in the areas of customer services, personnel, training, and general management.

If users are required to pay fees, then they must be furnished with reliable and quality service. And, for an SPC to be creditworthy, it must have sound management. In the long term, Mexico must look to the establishment of university-level training programs for engineers and administrators of SPC's in the water, wastewater and solid waste fields. In the short term, it can look to the U.S. Environmental Protection Agency (EPA) for technical assistance. The pilot Environmental Finance Center at the University of New Mexico can serve as just such a resource. In addition, reciprocal arrangements with American public utility districts could also be organized, as could contracts for management services with private companies. These programs must be developed to assure that the new autonomous SPCs will have cadres of qualified management candidates.

4. The BECC must assemble a binational team of experts and charge them with the mandate of identifying the legal and administrative issues which must be addressed to assure the integrity of the new financial system which the SPCs will employ. Good management is essential to good credit, but is not the only requirement. In a market-based financing system, a legal nexus must exist between the fees paid by a system's users and the payments made to the system's creditors. Pledges of system funds must be constitutionally enforceable. Lenders must have an absolute legal right to any fees pledged to them. Furthermore, there must be legal mechanisms in place to assure that such funds, once collected by a system, duly make their way to the system's creditors. In this regard, efforts must be made to identify what statutes,



similar to the U.S. Trust Indenture Act of 1940, must be enacted or amended, to assure that pledged funds will be properly handled and that there are strong legal sanctions against the careless and the criminal. Mexican banks, or other financial intermediaries, must also be able to offer the services provided by traditional registrars, trustees, and payment agents.

A determination must also be made as to what degree existing legal and administrative systems already in place for such public services as electric power and telecommunications can be used by, incorporated into, or readily adapted to the new environmental infrastructure SPCs.

In addition, the Mexican government must necessarily be concerned with both the level of pricing and the level of quality of the services to be provided by the new SPCs. Through its Secretariat for Social Development (SEDESOL), Mexico has the administrative apparatus to assure the quality of services. It may well have decided on an appropriate regulatory mechanism to control pricing. But to the extent these critical issues are not settled, the BECC should put its expertise at the disposal of the Mexican government in making these policy decisions.

5. The BECC must sponsor the creation of a large scale program of public education and information aimed at the actual users of the environmental infrastructure services. Those to whom new drinking water, wastewater and solid waste services are to be provided must be informed of these services. The nature of the services must be fully described and the level of service fully explained. Users must be told of the pricing levels; and they must be educated to the fact that the pricing corresponds directly to the level of delivered services and to a concomitant improvement in the basic quality of their lives. They must understand the sanctions for non-payment and that payments must be made on a regular and timely basis. Finally, they must have the right and the opportunity to seek redress for inferior service or faulty billing through new customer service systems which the SPCs must devise and adopt.

6. The BECC must retain an international financial advisor to advise it, at the onset, how to create a user-fee based program to fully leverage the NADBank's resources. On a continuing basis, the financial advisor can advise

the board on strategies which result in the NADBank's obtaining the lowest interest rates and most favorable terms for the financing of all border projects.

7. The EPA Administrator should request the Environmental Financial Advisory Board (EFAB), or another appropriate entity, to monitor the financial operations of the BECC in order to assure:

- A. that the BECC's programs and policies are financially sound;
- B. that the NADBank will remain solvent;
- C. that a BECC/NADBank strategy is implemented to fund all viable environmental infrastructure projects along the border; and,
- D. that the U.S. government will not be asked to appropriate any further funds for the NADBank beyond those provided in the bilateral side agreement.

\* \* \* \* \*

The creation of a sound and secure financial regime for the funding of environmental infrastructure along the border involves a massive effort. In addition to the training of the technical and administrative personnel and the enactment of appropriate statutory and constitutional safeguards, there remains the logistical problems of drawing demographic lines, constructing facilities and establishing user accounts. It will also be necessary to convince a skeptical public unaccustomed to receiving high levels of service that reliable payments are necessary to create and maintain systems of viable environmental services.

In order to marshal the resources necessary to accomplish this task, the Committee strongly recommends the creation of a prototype program involving one or more pilot or model projects. This work should not be done on an abstract basis; nor should the training programs be offered to random personnel; nor the public education and information programs be designed in

a vacuum. The environmental infrastructure needs along the border are enormous. Priority should, therefore, be given to identifying which areas can serve as models for others. Once these areas have been identified, the resources of the BECC should then be deployed to create a prototype program with these areas as models, so that the entire environmental infrastructure program contemplated by the NAFTA will have an ultimately realistic focus, and so that the lessons learned in the first few successful projects can be readily applied to the many other projects needed in the border area.

The overarching goal of the BECC and the NADBank is to help fund, both directly and indirectly, all viable environmental projects along the U.S. - Mexican border. Without local participation and accountability and a solid financial structure and strong financial programs, this great goal will never be reached. Therefore, the highest priority of the BECC must be the institutionalization of sound financial practices in order to assure the citizens of both the United States and Mexico that there will be sufficient funds available to meet all of the environmental needs of the border area.